FILE COPY

Office-Supreme Court, U.S.
FILED
FEB 20 1962
JOHN F. DAVIS, CLERK

No. 224

In the Supreme Court of the United States

OCTOBER TERM, 1961

THE HANOVER BANK, EXECUTOR, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL APPENDICES TO THE BRIEF FOR THE RESPONDENT

ARCHIBALD COX,
Solicitor General,
Department of Justice,
Washington 25, D.C.

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 224

THE HANOVER BANK, EXECUTOR, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL APPENDICES TO THE BRIEF FOR THE RESPONDENT

(Copies of the mortgages and indentures under which the bonds involved in these cases were issued are on file in this Court as part of the original record (Exh. 2–B and 3–C in *Gourielli;* Exh. 1–A, 2–B, and 3–C in *Goldfarb*) but, because of their length, were not reprinted in the printed record. For the Court's convenience, therefore, we have printed in the following Appendices relevant excerpts from the underlying indentures. Appendix A sets forth the provisions governing the redemption of the Appalachian Electric Power Company First Mortgage Bonds, 3¾% Series due 1981, purchased by the taxpayers in the *Gourielli* case; Appendix B, those governing the re-

demption of the Arkansas Power & Light Company First Mortgage Bonds, 4¼% Series due 1983, purchased by the taxpayer in the *Goldfarb* case.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

FEBRUARY 1962.

APPENDIX A

Indenture Provisions Governing Appalachian Electric Power Company First Mortgage Bonds, 3¾% Series Due 1981

By a Mortgage and Deed of Trust dated December 1, 1940, the Appalachian Electric Power Company conveyed substantially all its properties to trustees to secure First Mortgage Bonds to be issued pursuant to the terms of the accompanying indenture. The indenture authorized the immediate issuance of a series of bonds in the principal amount of $70,000,000 (the 1970 Series) and the issuance of additional series on the basis of subsequent property additions. Three additional series, in the principal amounts of $28,000,000 (the 1977 Series), $25,000,000 (the 1980 Series), and $17,000,000 (the 1981 Series), were issued pursuant to supplemental indentures executed, respectively, in 1947, 1950, and 1951. The bonds purchased by the taxpayers in the *Gourielli* case were of the 1981 Series, and their redemption was therefore governed by the provisions of the original indenture, dated December 1, 1940 (Exh. 2–B), as supplemented and modified by the 1951 Supplemental Indenture, dated June 1, 1951 (Exh. 3–C). The relevant provisions are set forth below. The provisions added or modified by the 1951 Supplemental Indenture are indicated by an asterisk.

SECTION 20.*

* * * * *

The Company covenants that, so long as any of the bonds of the 1981 Series remain outstanding, it will on or before March 1 of each year beginning with the year 1953 deliver to the Corporate Trustee:

(X) A Treasurer's certificate which shall state:

(aaa) the greatest principal amount of all bonds of the 1981 Series theretofore at any one time outstanding; and

(bbb) the cost or then fair value to the Company (whichever is less), as shown by an engineer's certificate such as is described in subdivision (3) of Section 29 hereof, of any property additions which are not then funded property and which the Company elects to make the basis of a credit under this Section; and/or

(ccc) the aggregate principal amount of any bonds or fractions of a bond to the authentication and delivery of which the Company shall then be entitled under any of the provisions of this Indenture (other than on the basis of property additions or a deposit of cash), and which the Company elects not to have authenticated and delivered hereunder; and that the Company waives such right to the authentication and delivery of each such bond or fraction thereof and elects to make the waiver of such right the basis of a credit under this Section.

(Y) An amount in cash and/or principal amount of bonds of the 1981 Series equivalent to one per centum (1%) of the greatest principal amount of bonds of the 1981 Series theretofore at any one time outstanding; provided, however, that there shall be credited against the amount of cash or bonds payable or deliverable pursuant to this paragraph (Y), (1) sixty per centum (60%) of the cost or then fair value, whichever is less, of any property addi-

tions which shall be set forth pursuant to clause (bbb) of the Treasurer's certificate provided for by paragraph (X) of this Section and (2) the principal amount of the bonds set forth pursuant to clause (ccc) of the Treasurer's certificate provided for by paragraph (X) of this Section. All cash deposited by the Company with the Corporate Trustee pursuant to the provisions of this paragraph (Y) of this Section may be withdrawn, used or applied in the manner, to the extent, for the purposes and subject to the conditions provided in Section 67 hereof, except that (a) under the provisions of subdivision (1) thereof, such cash may be withdrawn only in an amount equal to one hundred per centum (100%) of the principal amount of each bond or fraction of a bond to the authentication and delivery of which the Company shall be entitled under any of the provisions of this Indenture (other than those contained in Section 31 hereof) and (b) under the provisions of subdivisions (2) and (3) thereof, such cash may be applied only to the purchase or redemption of bonds of the 1981 Series.

* * * * *

SECTION 20C.* The Company hereby creates a fourth series of bonds to be issued under and secured by this Indenture, to be designated and to be distinguished from the bonds of all other series, by the title "First Mortgage Bonds, 3¾% Series due 1981", herein called bonds of the 1981 Series. The form of the bonds of the 1981 Series and of the appurtenant coupons shall be substantially as set forth in the 1951 Supplemental Indenture.

* * * * *

Any or all of the bonds of the 1981 Series shall be redeemable by the Company, at its option, or by operation of various provisions of this Indenture, at

any time and from time to time upon notice published in at least one daily newspaper printed in the English language, and published and of general circulation in the Borough of Manhattan, The City of New York, at least once in each of four (4) successive calendar weeks upon any business day of each such calendar week, the first publication to be at least thirty (30) but not more than ninety (90) days prior to the date fixed for redemption, at the principal amount thereof and accrued interest to such date of redemption, together, if redeemed otherwise than by the use or application of cash deposited pursuant to Section 20 or Section 40 of this Indenture and otherwise than by the use of proceeds of released property or the proceeds of insurance, with a premium equal to a percentage of the principal amount thereof determined as set forth in the tabulation below under the heading "Regular Redemption Premium", and, if redeemed by the use or application of cash deposited pursuant to Section 20 or Section 40 of this Indenture or by the use of proceeds of released property or the proceeds of insurance, with a premium equal to a percentage of the principal amount thereof determined as set forth in the tabulation below under the heading "Special Redemption Premium":

Year	Regular Redemption Premium	Special Redemption Premium
	(If redeemed prior to June 1 of the calendar year stated and subsequent to the last day of May of the calendar year next preceding such year)	
1962	5¾%	2¾%
1963	5¼	2½
1964	5¼	2½
1965	5¼	2¼
. . .	. . .	. . .
1978	¼	¼

and without premium in either case if redeemed on or after June 1, 1979 and prior to maturity.

SECTION 24.* Bonds in addition to those provided for in [Section 22] hereof and of any one or more series may from time to time be executed by the Company and delivered to the Corporate Trustee, and shall be authenticated by the Corporate Trustee and delivered from time to time in accordance with the order or orders of the Company * * * upon the basis of property additions but only in accordance with and subject to the conditions, provisions and limitations set forth in the next succeeding five Sections of this Indenture, numbered from 25 to 29, both inclusive; * * *.

* * * * *

SECTION 26.* Bonds of any one or more series shall be authenticated and delivered under the provisions of [Sections 24–29] upon the basis of property additions, for a principal amount not exceeding seventy per centum (70%) [effectively reduced to 60% by Section 4 of the 1951 Supplemental Indenture] of the cost or of the then fair market value thereof to the Company) (whichever shall be less). * * *

* * * * *

SECTION 39. [The Company hereby covenants that] it will keep all the mortgaged and pledged property insured against loss or damage by fire to the extent that property of similar character is usually so insured by companies similarly situated and operating like properties * * *.

All moneys received by the Corporate Trustee as proceeds of any insurance against loss or damage by fire shall be held by the Corporate Trustee and shall be paid by it to the Company to reimburse the Company for an equal amount spent in the rebuilding or renewal of the property destroyed or damaged, * * *.

Any such money not so applied within eighteen (18) months * * * shall thereafter be withdrawn, used or applied in the manner, to the extent and for the purposes and subject to the conditions provided in Section 67 hereof.

SECTION 40. [The Company hereby covenants that] it will, at all times, make or cause to be made such expenditures by means of repairs, maintenance, substitutions of property or otherwise as shall be necessary to maintain, preserve and keep the mortgaged property in good repair, working order and condition as an operating system or systems; that, in furtherance thereof, within four months after the close of the calendar year 1941 and of each year thereafter, it will furnish to the Corporate Trustee a Treasurer's certificate, hereinafter referred to as Treasurer's maintenance certificate * * *, showing the following:

(a) The base operating revenues of the Company for the preceding calendar year * * *;

(b) Expenditures during the preceding calendar year for repairs and maintenance to the mortgaged property;

(c) Expenditures during the preceding calendar year, for property acquired, made or constructed by the Company to renew or replace, or in substitution for, or in lieu of any property of the Company retired subsequent to August 31, 1940 * * *;

(d) The cost or then fair value to the Company (whichever is less), as shown by an engineer's certificate such as is described in subdivision (3) of Section 29 hereof, of any property additions which are not then funded property and which the Company elects to make the basis of a credit under this Section. * * *;

(e) The amount, if any, hereinafter sometimes referred to as the "Credit", by which the aggregate of the amounts of Items (b), (c) and (d) exceeds a percentage of the base operating

revenues as shown in Item (a) above, which percentage shall be determined in accordance with the facts shown in paragraph (g) of the Treasurer's maintenance certificate;

(f) The amount, if any, hereinafter sometimes referred to as the "Deficit", by which the aggregate of the amounts of Items (b), (c) and (d) falls to equal a percentage of the base operating revenues as shown in Item (a) above, which percentage shall be determined in accordance with the facts shown in paragraph (g) of the Treasurer's maintenance certificate;

(g) * * * the percentage of base operating revenues for the computation in paragraphs (e) and (f) of the Treasurer's maintenance certificate shall be fifteen per centum (15%) [reduced to 14% or 13% in prescribed circumstances] * * *.

* * * * *

In case any Treasurer's maintenance certificate shows a Deficit under Item (f) the Company covenants that it will, concurrently with the filing of such certificate, deposit with the Corporate Trustee, an amount in cash and/or bonds of any series of a principal amount equal to the amount of such Deficit. The Corporate Trustee shall hold * * * any cash received by it under this Section as part of the mortgaged and pledged property. Any cash * * * deposited under this Section, may at any time * * * be withdrawn by the Company upon the deposit with the Corporate Trustee of a principal amount of bonds of any series equal to the amount of cash so withdrawn. * * *

* * * * *

SECTION 57. Such of the bonds of any series issued hereunder as are, by their terms, redeemable before maturity may, at the option of the Company, be redeemed at such times, in such amounts and at such prices as may be specified therein and in accordance

with the provisions of the three next succeeding Sections numbered from 58 to 60, both inclusive.

SECTION 58. In case of a redemption of a part only of any series of said bonds, the particular bonds so to be redeemed shall be selected by the Corporate Trustee by lot, according to such method as it shall deem proper in its discretion. Notice of intention to redeem (including in case a part only of the bonds of any particular series are to be redeemed, the numbers of such bonds), shall be given * * * in such * * * newspapers and for such periods as may be fixed for the bonds of such other series by the resolutions establishing such series of bonds * * *.

* * * * *

SECTION 59. So long as the Company is not in default * * *, the Company may obtain a release of any of the mortgaged and pledged property, except cash then held by the Corporate Trustee * * *, and the Trustee shall execute and deliver a release of the same from the lien hereof upon the application of the Company and receipt by the Corporate Trustee of

* * * * *

(3) * * * [an engineer's certificate stating:] (a) the fair value, in the opinion of the signers, of the property to be released; (b) what portion, if any, of the property to be released is funded property; (c) that such release is in the opinion of the signers desirable in the conduct of the business of the Company; and (d) that such release will not impair the security under this Indenture in contravention of the provisions hereof;

* * * * *

(5) an amount in cash, to be held by the Corporate Trustee as part of the mortgaged and pledged property, equivalent to the amount, if any, by which the fair value of the prop-

erty to be released, as specified in the engineer's certificate * * *, exceeds the aggregate of the following items:

(a) the principal amount of any obligations delivered to the Corporate Trustee, to be held as part of the mortgaged and pledged property, consisting of obligations secured by purchase money mortgage upon the property released * * *; and

(b) one hundred forty-two and six-sevenths per centum (142⅞%) of the principal amount of each bond or fraction of a bond to the authentication and delivery of which the Company shall be entitled under any of the provisions of this Indenture * * * but which have not been authenticated and delivered; provided, however, that the application for such release shall * * * operate as a waiver by the Company of such right to the authentication and delivery of each such bond or fraction thereof on the basis of which right such funded property is released * * *.

* * * * *

Any * * * moneys and/or purchase money obligations and/or other property and/or the proceeds of any thereof and/or substitutes therefor received by the Corporate Trustee under this Section shall be held as part of the mortgaged and pledged property and such moneys and/or purchase money obligations shall be paid over, withdrawn, used or applied, in the manner, to the extent, and for the purposes and subject to the conditions provided in Section 67 hereof.

Any such release of property may be procured as above provided whether or not the Company has sold or otherwise disposed of the property or contracted so to do; but no such release shall be operative to free the property therein described from the lien of this

Indenture until the Company shall have conveyed, transferred or otherwise disposed of the property covered thereby.

* * * * *

SECTION 67. So long as the Company is not in default * * *, any money received by the Trustees, or either of them, in consideration of any release under [Sections 63–70], including payment on account of the principal of any obligations secured by purchase money mortgage so received, shall be paid to and held by the Corporate Trustee, and such money and any other money which may be applied as in this Section provided,

(1) may be withdrawn from time to time by the Company in an amount equal to one hundred forty-two and six-sevenths per centum (142-6/7%) of the principal amount of each bond or fraction of a bond to the authentication and delivery of which the Company shall be entitled under any of the provisions of this Indenture * * *; provided, however, that any request for such withdrawal under this subdivision shall * * * operate as a waiver by the Company of such right to the authentication and delivery of each such bond or fraction thereof on the basis of which right such funded cash is withdrawn * * *; or

(2) may, upon the request of the Company, evidenced by a resolution delivered to the Corporate Trustee, be used by the Corporate Trustee for the purchase of bonds issued hereunder * * *; or

(3) may, upon the request of the Company, evidenced by a resolution delivered to the Corporate Trustee, be applied by the Corporate Trustee to the redemption of any bonds issued hereunder as are by their terms redeemable before maturity, of such series as may be des-

ignated by the Company, such redemption to be in the manner and as provided in [Sections 57–62] hereof.

* * * * *

SECTION 68. So long as the Company is not in default * * *, should any of the mortgaged and pledged property be taken by exercise of the power of eminent domain or should the Company pursuant to an obligation now existing or hereafter incurred as a condition to obtaining any franchise, sell or otherwise dispose of any part of the mortgaged and pledged property at any time and, in connection with such exercise of the power of eminent domain or such sale or disposition, should a price for such property be determined pursuant to any proceeding in which interested persons shall have had the right to appear and be heard, such price so determined shall be deemed to be the fair value of such property and shall be binding upon the Trustees as such. In any such case the Trustees shall release the property so taken, sold or otherwise disposed of * * *. The proceeds of all property so taken, sold or otherwise disposed of shall be paid over to the Corporate Trustee * * *, and * * * may thereafter be withdrawn, used or applied in the manner, to the extent and for the purposes and subject to the conditions provided in Section 67 hereof.

* * * * *

APPENDIX B

Indenture Provisions Governing Arkansas Power & Light Company First Mortgage Bonds, 4¼% Series Due 1983

By a Mortgage and Deed of Trust dated October 1, 1944, the Arkansas Power & Light Company conveyed substantially all its properties to trustees to secure First Mortgage Bonds to be issued pursuant to the terms of the accompanying indenture. The indenture authorized the immediate issuance of a series of bonds in the principal amount of $30,000,000 (the 1974 Series) and issuance of additional series on the basis of subsequent property additions. Seven additional series, in principal amounts of $11,000,000 (the 1977 Series), $7,500,000 (1978 Series), $8,700,000 (the 1979 Series), $6,000,000 (the 1980 Series), $8,000,000 (the 1981 Series), $15,000,000 (the 1982 Series) and $18,000,000 (the 1983 Series) were issued pursuant to supplemental indentures executed, respectively, each year from 1947 through 1953. The bonds purchased by the taxpayer in the *Goldfarb* case were of the 1983 (or Eighth) Series, and their redemption was governed by provisions of the original indenture, dated October 1, 1944 (Exh. 1–A), as supplemented and modified by the Third Supplemental Indenture, dated October 1, 1949 (Exh. 2–B), and the Seventh Supplemental Indenture, dated June 1, 1953 (Exh. 3–C). The relevant provisions of the Seventh Supplemental Indenture, pursuant to which the bonds were issued, are set forth below, followed by the relevant portions of the original indenture.

SEVENTH SUPPLEMENTAL INDENTURE DATED JUNE 1, 1953

* * * * *

SECTION 1. There shall be a series of bonds designated "4¼% Series due 1983" (herein sometimes referred to as the "Eighth Series") * * *.

* * * * *

(I) Bonds of the Eighth Series shall be redeemable either at the option of the Company or pursuant to the requirements of the Mortgage in whole at any time, or in part from time to time, prior to maturity, upon notice published as provided in Section 52 of the Mortgage, * * * the first publication, or mailing, as the case may be, to be at least thirty (30) days prior to the date fixed for redemption, at the following general redemption prices, expressed in percentages of the principal amount of the bonds to be redeemed:

GENERAL REDEMPTION PRICES

If Redeemed During 12 Months Period Ending May 31,

1954	105.39%
1955	105.18%
1956	105.09%
1957	104.81%
*	*
1982	100.19%
1983	100.00%

in each case, together with accrued interest to the date fixed for redemption.

(II) Bonds of the Eighth Series shall also be redeemable in whole at any time, or in part from time to time, prior to maturity, upon like notice, by the

application (either at the option of the Company or pursuant to the requirements of the Mortgage) of cash delivered to or deposited with the Corporate Trustee pursuant to the provisions of Section 39 or Section 64 of the Mortgage or of Section 2 hereof or Section 3 of the Third Supplemental Indenture or with the proceeds of Released Property; provided, however, that in the case of application of cash delivered to the Corporate Trustee pursuant to the provisions of Section 2 hereof, if the date fixed for such redemption shall be prior to January 1 of the calendar year in which such delivery of cash shall become due under the provisions of Section 2 hereof, they shall be redeemable at the general redemption prices set forth in subdivision (I) of this Section, together with accrued interest to the date fixed for redemption; and provided further, that

(1) in the case of application of cash delivered to the Corporate Trustee pursuant to the provisions of either (a) Section 39 of the Mortgage or Section 3 of the Third Supplemental Indenture or (b) Section 2 hereof if in such latter case the date fixed for such redemption shall be on or after January 1 of the calendar year in which such delivery of cash shall become due under the provisions of Section 2 hereof, or

(2) in the case of redemption by the application of cash deposited with the Corporate Trustee pursuant to the provisions of Section 64 of the Mortgage or with the Proceeds of Released Property,

they shall be redeemable at the following special redemption prices, expressed in percentages of the principal amount of the bonds to be redeemed:

SPECIAL REDEMPTION PRICES

If Redeemed During 12 Months Period Ending May 31,

1954	101.25%
1955	101.25%
1956	101.25%
1957	101.25%
. . . . .	.
1962	100.25%
1963	100.00%

in each case, together with accrued interest to the date fixed for redemption.

. . . . . .

SECTION 2. The Company covenants that, so long as any of the bonds of the Eighth Series shall remain Outstanding, it will, on or before October 1, 1954, and on or before October 1 of each year thereafter, to and including the year 1962, deliver to the Corporate Trustee:

(A) An Officers' Certificate which shall state:

(a) the greatest principal amount of all bonds of the Eighth Series prior to January 1 of such year at any one time Outstanding;

(b) the aggregate principal amount of all bonds of the Eighth Series retired prior to the date of such Officers' Certificate pursuant to the provisions of subdivision (3) or subdivision (4) of Section 61 of the Mortgage by use or application of the proceeds of insurance on, the release or other disposition of, or the taking by eminent domain of, property, or pursuant to the provisions of Section 64 of the Mortgage;

(c) the aggregate principal amount of bonds the right to the authentication and delivery of which (on the basis of the retirement of bonds of the Eighth Series) shall have been waived prior to the date of such Officers' Certificate pursuant to the provisions of clause (c) of subdivision (4) of Section 59 of the Mortgage as

the basis of the release of property or pursuant to the provisions of subdivision (2) of Section 61 of the Mortgage as the basis of the withdrawal of cash representing proceeds of insurance on, the release or other disposition of, or the taking by eminent domain of, property;

(d) the amount remaining after deducting the sum of the amounts stated pursuant to clauses (b) and (c) above from the amount stated pursuant to clause (a) above;

(e) the amount which is one per centum (1%) of the amount stated pursuant to clause (d) above; and

(f) the aggregate principal amount, if any, of bond(s) or fraction of a bond to the authentication and delivery of which the Company shall then be entitled on the basis of Property Additions or on the basis of the retirement of bonds of the Eighth Series by virtue of compliance with all applicable provisions of the Mortgage (except as hereinafter in this Section otherwise provided) if the Company elects to make its right to the authentication and delivery of such bond(s) or fraction of a bond the basis of a credit under this Section.

(B) An amount in cash and/or principal amount of bonds of the Eighth Series equivalent to the amount stated in the Officers' Certificate (due on or before October 1 of such year) provided for by this Section pursuant to the requirements of clause (e) of subdivision (A) of this Section; provided, however, that, against the amount of cash or bonds payable or deliverable pursuant to this paragraph (B), there shall be credited the principal amount of the bonds which shall be stated in such Officers' Certificate pursuant to the requirements of clause (f) of subdivision (A) of this Section.

Such cash together with any bonds of the Eighth Series delivered to the Corporate Trustee under the provisions of this Section shall be dealt with as provided for by this Section.

Notwithstanding any other provisions of this Seventh Supplemental Indenture or of the Mortgage, (i) the Company shall be permitted from time to time to anticipate in whole or in part the requirements of this Section becoming due on October 1 of the then current year or any subsequent year or years by depositing cash and/or a principal amount of bonds of the Eighth Series with the Corporate Trustee in full satisfaction or in partial satisfaction of the requirements of this Section and (ii) any cash so deposited, whether in full satisfaction or in partial satisfaction of the requirements of this Section and whether becoming due on October 1 of the then current year or of a subsequent year, may be from time to time withdrawn, used or applied in the manner, to the extent, for the purposes and subject to the conditions provided in Section 31 of the Mortgage or in subdivision (3) and/or (4) of Section 61 of the Mortgage; provided, however, that the retirement of no bonds of any series other than the Eighth Series shall be made the basis of the withdrawal of cash deposited under this Section and, provided further that no bonds of any series other than the Eighth Series shall be purchased or redeemed with cash deposited under the provisions of this Section and that no bonds of the Eighth Series shall be purchased with cash deposited under this Section at such price (including accrued interest and brokerage) that the cost thereof to the Company is in excess of the cost of redeeming such bonds on a date forty (40) days after the date of such purchase (including premium, if any, and accrued

interest from the interest date next preceding the date of purchase to such redemption date in such case).

* * * * *

MORTGAGE AND DEED OF TRUST DATED OCTOBER 1, 1944

* * * * *

SECTION 23. Bonds in addition to those provided for in other Sections hereof and of any one or more series may from time to time be executed by the Company and delivered to the Corporate Trustee, and shall be authenticated by the Corporate Trustee and delivered from time to time in accordance with the written order or orders of the Company signed by its President or a Vice-President and its Treasurer or an Assistant Treasurer upon the basis of Property Additions, but only in accordance with and subject to the conditions, provisions and limitations set forth in the next succeeding five Sections of this Indenture, numbered from 24 to 28, both inclusive.

* * * * *

SECTION 25. Bonds of any one or more series may be authenticated and delivered under the provisions of [Sections 23–28] upon the basis of Property Additions for a principal amount not exceeding sixty per centum (60%) of the balance of the Cost or of the fair value thereof to the Company (whichever shall be less) after making any deductions and any additions required by Section 4 hereof.

* * * * *

SECTION 37. [The Company hereby covenants that] it will keep or cause to be kept all the property subject to the Lien hereof insured against fire to the extent that property of similar character is usually

so insured by companies similarly situated and operating like properties * * *.

All moneys paid to the Corporate Trustee by the Company in accordance with this Section or received by the Corporate Trustee as proceeds of any insurance against loss by fire shall * * * be held by the Corporate Trustee and, * * * [upon request], shall be paid by it to the Company to reimburse the Company for an equal amount spent in the rebuilding or renewal of the property destroyed or damaged * * *.

Any such money not so applied within eighteen (18) months * * * shall thereafter be withdrawn, used or applied in the manner, to the extent and for the purposes and subject to the conditions provided in Section 61 hereof.

* * * * *

Section 39. (1) The Company covenants that, so long as any bonds of the First Series [Second through Eighth Series added by supplemental indentures] remain outstanding, it will, within ninety (90) days after the close of the calendar year 1945 and of each calendar year thereafter, file with the Corporate Trustee an Officers' Certificate (hereinafter called an "Officers' Certificate of Maintenance and Replacements"), stating the following:

(1) the amount which is equal to (x) fifteen per centum (15%) of the Electric, Gas, Steam and Hot Water Adjusted Gross Operating Revenues * * *, plus (y) twenty-five per centum (25%) of the Little Rock Railway and Transportation Adjusted Gross Operating Revenues * * * for the calendar year next preceding such filing;

(2) gross expenditures of the Company or others subsequent to September 30, 1944, for repairs and maintenance of the Mortgaged and Pledged Property * * *;

(3) an amount equal to the aggregate amounts deducted pursuant to the provisions of clause (A) of Section 4 hereof from the Cost or fair value of Property Additions in respect of Funded Property retired * * *;

(4) the Cost or fair value to the Company, whichever is less, * * * of any (gross) Property Additions which are not then Funded Property * * * and which Property Additions the Company then elects to make the basis of a credit under this subsection (I);

(5) the principal amount of each bond to the authentication and delivery of which the Company shall then be entitled under the provisions of Section 26 or Section 29 hereof * * *; and that the Company elects to make its right to the authentication and delivery of such bond the basis of a credit under this subsection (I);

(6) expenditures subsequent to September 30, 1944, for gross additions to automotive equipment of the Company * * * [etc.], which expenditures shall not theretofore have been made the basis of a credit under this subsection (I) and which expenditures the Company then elects to make the basis of a credit under this subsection (I);

(7) the amount, if any, required to be stated by clause (8) below in the next preceding Officers' Certificate of Replacements, if any;

(8) the amount, if any, by which the aggregate of the amounts required to be stated by clauses (2) to (7), both inclusive, above in the certificate then being made exceeds the amount required to be stated by clause (1) above in such certificate; and

(9) the amount, if any, by which the aggregate of the amounts required to be stated in clauses (2) to (7), both inclusive, above by the certificate then being made is less than the amount required to be stated by clause (1) above in such certificate.

* * * * *

The Company covenants to deposit with the Corporate Trustee in cash within ninety (90) days after the close of such period and of each such calendar year an amount equal to any amount required to be stated by clause (9) above in the Officers' Certificate of Maintenance and Replacements required to be filed within such ninety (90) day period.†

Any cash delivered to the Corporate Trustee under the provisions of this subsection (I) shall be held by it as part of the Mortgaged and Pledged Property and

* * * * *

[(a)–(e) permit withdrawals on the basis of property additions, *etc.*, or for the purchase of bonds]; or

(f) may, upon the request of the Company, be applied by the Corporate Trustee to the redemption of any bonds issued hereunder which are, by their terms, redeemable before maturity of such series as may be designated by the Company, such redemption to be in the manner and as provided in [Sections 51–56] hereof.

* * * * *

(II) If at any time cash in excess of Fifty Thousand Dollars ($50,000) shall have remained on deposit with the Corporate Trustee under the provisions of subsection (I) of this Section for a period of five years, with respect to which the Company shall not

---

† Section 3(II) of the Third Supplement Indenture (Exh. 2–B), applicable to the Fourth and subsequent series, requires certain additional deposits (or other credits) to the Maintenance and Replacement Fund. Depending upon the provisions for depreciation and retirement ordered by the state regulatory authority, that section may require credits to the Fund of up to 20% of the non-transportation revenues, rather than 15% of those revenues plus 25% of the transportation revenues, as is required by Section 39(I)(1) of the original indenture.

have made a proper request for the withdrawal, use or application of the same as in said subsection (I) provided, all cash so remaining on deposit shall be applied by the Corporate Trustee to the purchase or redemption of bonds in accordance with the provisions of [Sections 51–56] hereof, and the Corporate Trustee shall have power to give all necessary notices and to do all other acts and things to effect such purchase or redemption.

* * * * *

SECTION 51. Such of the bonds of any series issued hereunder as are, by their terms, redeemable before maturity, may, at the option of the Company, be redeemable at such times, in such amounts and at such prices as may be specified therein and in accordance with the provisions of the three next succeeding Sections numbered from 52 to 54, both inclusive.

SECTION 52. (A) In case of a redemption of a part only of any series of said bonds, * * * the particular bonds so to be redeemed shall be designated by the Corporate Trustee by lot, according to such method as it shall deem proper in its discretion. In any such designation by lot the designation may be made from the numbers of the bonds of such Series then Outstanding (1) in groups of consecutive numbers * * * or (2) individually from the numbers of all such bonds * * *, or (3) if there is any portion to be called which is but a fraction of a group, individually by lot from the several individual numbers in any such group so designated by lot.

* * * * *

Notice of intention to redeem * * * shall be given, by or on behalf of the Company, by publication * * *

at least thirty (30) days prior to the date fixed for redemption * * *. If less than all bonds of any particular series are to be redeemed, the numbers of any bonds to be redeemed * * * shall be included in such notice * * *.

* * * * *

SECTION 59. Unless the Company is in default * * *, the Company may obtain the release of any of the Mortgaged and Pledged Property, except cash then held by the Corporate Trustee * * *, and the Trustees or the Corporate Trustee shall release all the right, title and interest of the Trustees in and to the same from the Lien hereof upon the application of the Company and receipt by the Corporate Trustee of

* * * * *

(3) an Engineer's Certificate, made and dated not more than ninety (90) days prior to the date of such application, stating:

(a) that the Company has sold, exchanged, dedicated or disposed of, or agreed to sell, exchange, dedicate or dispose of, or that a governmental body or agency has exercised a right to order the Company to divest itself of, the property to be released; (b) the fair value, in the opinion of the signers, of the property (or securities) to be released; * * * [and] (d) that (except in any case where a governmental body or agency has exercised a right to order the Company to divest itself of such property) such release is in the opinion of the signers desirable in the conduct of the business of the Company * * *;

(4) an amount in cash, to be held by the Corporate Trustee as part of the Mortgaged and Pledged Property, equivalent to the amount, if any, by which the fair value of the property to be released, as specified in the

Engineer's Certificate provided for in subdivision (3) above, exceeds the aggregate of the following items:

(a) the principal amount * * * of any obligations delivered to the Corporate Trustee, to be held as part of the Mortgaged and Pledged Property, consisting of obligations secured by purchase money mortgage upon the property released;

(b) the Cost or fair value to the Company (whichever is less) of any Property Additions made the basis of the application which are not then Funded Property * * *; [and]

(c) the principal amount of each bond or fraction of bond to the authentication and delivery of which the Company shall be entitled under the provisions of Section 26 or Section 29 hereof * * *; provided, however, that * * * the application for such release shall operate as a waiver by the Company of such right to the authentication and delivery of each such bond or fraction thereof on the basis of which right such property is released * * *.

* * * * *

* * * [A]ny moneys and/or obligations secured by purchase money mortgage * * * received by the Corporate Trustee under this Section shall be held as part of the Mortgaged and Pledged Property and * * * shall be paid over, withdrawn, used or applied, in the manner, to the extent, and for the purposes and subject to the conditions provided in Section 61 hereof.

* * * * *

SECTION 61. Unless the Company is in default * * * any money received by the Corporate Trustee in consideration of any release under [Sections 57–63], including payment on account of the principal of any obligations secured by purchase money mortgage which obligations have been delivered to the Corporate Trus-

tee, shall be held by the Corporate Trustee and, subject to the provisions of Section 64 hereof, such money and any money which may be applied as in this Section provided,

(1) may be withdrawn from time to time by the Company to the extent of the Cost or the fair value to the Company (whichever is less) of Property Additions not then Funded Property * * *;

(2) may be withdrawn from time to time by the Company in an amount equal to the principal amount of each bond or fraction of bond to the authentication and delivery of which the Company shall be entitled under the provisions of Section 26 or Section 29 hereof * * *; provided, however, that * * * the application for such withdrawal of cash shall operate as a waiver by the Company of such right to the authentication and delivery of each such bond or fraction thereof, on the basis of which right such cash is withdrawn * * *;

(3) may, upon the request of the Company, be used by the Corporate Trustee for the purchase of bonds issued hereunder * * *; or

(4) may, upon the request of the Company, be applied by the Corporate Trustee to the payment at maturity of any bonds issued hereunder or to the redemption of any bonds issued hereunder which are, by their terms, redeemable before maturity, of such series as may be designated by the Company, such redemption to be in the manner and as provided in [Sections 51–56] hereof.

* * * * *

SECTION 62. Should any of the Mortgaged and Pledged Property be taken by exercise of the power of eminent domain or should any governmental body or agency, at any time, exercise any right which it may have to purchase or designate a purchaser of any part of the Mortgaged and Pledged Property, the

Trustee or the Corporate Trustee shall, upon request of the Company, evidenced by a Resolution, release from the Lien hereof, all the right, title and interest of the Trustees in and to the property so taken or purchased * * *. [T]he amount of net proceeds received or to be received for such property so taken or purchased * * * shall be deemed to be the fair value of such property * * *. An amount equal to the net proceeds of all property so taken or purchased (which proceeds shall, in either event, be required to be entirely in the form of cash) shall be paid over to the Corporate Trustee * * *, and * * * may, subject to the provisions of Section 64 hereof, thereafter be withdrawn, used or applied in the manner, to the extent and for the purposes and subject to the conditions provided in Section 61 hereof.

* * * * *

SECTION 64. (I) If during any twelve (12) months' period, any of the Mortgaged and Pledged Property is taken by the exercise of the power of eminent domain and/or any governmental body or agency exercises any right which it may have to purchase * * * [and/or] to order the Company to divest itself of any of such property, with the result that (during such period) the Company receives or becomes entitled to receive (during such period or otherwise) proceeds, in cash and/or a principal amount of obligations secured by purchase money mortgage, aggregating not less than Ten Million Dollars ($10,000,000), at a time or times when any bonds Outstanding hereunder are, by their express terms, redeemable before maturity by the application of cash deposited pursuant to the provisions of this Section, the Company covenants that (to the extent that any cash received by the Company for such property * * * has not theretofore been applied to

the purchase or redemption of bonds secured hereby * * *), the Company will deposit cash in an amount equal to the cash (less * * * the principal amount of bonds the right to the authentication and delivery of which pursuant to the provisions of Section 6 or Section 29 hereof shall have been waived as the basis of the release of said property * * *) theretofore or * * * thereafter received for said property, including cash received on account of principal of such obligations as aforesaid, with the Corporate Trustee under the provisions of this Section (all of which deposits shall be deemed to have been made pursuant to the provisions of this Section), and, subject to Section 119 hereof, will (to the extent that any cash so deposited is not applied, within four months after the date deposited, to the purchase or redemption of bonds Outstanding hereunder, pursuant to the provisions of [Sections 51–56] hereof) irrevocably direct the Corporate Trustee to apply the cash so deposited with the Corporate Trustee to the redemption of bonds Outstanding hereunder pursuant to the provisions of [Sections 51–56] hereof to the extent that bonds then Outstanding hereunder are, by their express terms, redeemable before maturity by the application of cash deposited pursuant to the provisions of this Section.

* * * * * *

U.S. GOVERNMENT PRINTING OFFICE: 1942

SUPREME COURT OF THE UNITED STATES

No. 224.—October Term, 1961.

The Hanover Bank, Executor, et al., Petitioner, v. Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[May 21, 1962.]

Mr. Chief Justice Warren delivered the opinion of the Court.

Despite the seemingly complex factual composition of the two cases consolidated herein,[1] this opinion deals with a relatively simple question of taxation: The extent to which a taxpayer may deduct, through amortization under the Internal Revenue Code of 1939, the premium he has paid in purchasing corporate bonds. In 1953, prior to December 1, the petitioners purchased fully taxable utility bonds at a premium above maturity value.[2] The bonds were callable at the option of the issuer at either

[1] We have before us two cases which originated in the Tax Court: *Gourielli* v. *Commissioner*, 33 T. C. 357, and *Goldfarb* v. *Commissioner*, 33 T. C. 568. The cases were consolidated on appeal to the Court of Appeals for the Second Circuit, and one opinion was filed by that court. *Estate of Gourielli* v. *Commissioner*, 289 F. 2d 69. Petitioner Hanover Bank is the executor of the estate of Mr. Gourielli, who passed away since the commencement of this action.

[2] The bonds involved in the *Gourielli* case were Appalachian Electric Power Company, 1981 series, bonds, which decedent and his wife purchased for $117.50 per $100 face value, and which were later sold for $115.50. The bonds in *Goldfarb* were Arkansas Power & Light Company, 30-year, Eighth Series, bonds, which petitioners purchased at an average price of $110.50 per $100 face amount, and which were later sold at an average price of $105.40. The total purchases in the two cases were $540,000 (Gourielli) and $500,000 (Goldfarb) face amount; the purchase prices were paid in cash in both cases.

a general or special call price, and at either price they were callable upon 30 days' notice. The term "general call price" is used to designate the price at which the issuer may freely and unconditionally redeem all or any portion of the outstanding bonds from its general funds. The lower, "special call price," is the amount the issuer would pay if the bonds were redeemed with cash from certain specially designated funds.[3]

In computing net income, the 1939 Code permits a taxpayer to deduct, through amortization, the premium he has paid in purchasing corporate bonds.[4] Section 125 of the Code, set forth in pertinent part in the margin,[5] pro-

---

[3] In addition to a "sinking fund" into which the indenture required Appalachian to deposit during each annual period an amount (in cash or property additions of an equivalent amount) equal to one percent of the bond issue, the special funds in the case of the Appalachian bonds were: (1) a released property and insurance fund, to which deposits were required only upon a loss by casualty or by a release of mortgaged properties securing the bonds; and (2) a maintenance fund, to which deposits were required only when Appalachian failed to expend a stated percentage of its revenues on maintenance or improvements. The special funds in the case of the Arkansas bonds were made up from the same-type contributions as above, plus additions made to an eminent domain fund if and when mortgaged property was taken from the company by eminent domain proceedings.

[4] Internal Revenue Code of 1939 (26 U. S. C., 1952 ed.):

"Section 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

. . . . . .

"(v) [as added by § 126 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] BOND PREMIUM DEDUCTION.—In the case of a bondholder, the deduction for amortizable bond premium provided in section 125."

[5] This Section was also added by the Revenue Act of 1942, *supra*, note 4, § 126 (b). Entitled "Amortizable Bond Premium," it reads in pertinent part as follows:

"(a) GENERAL RULE. In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond

vides that the amount of bond premium to be amortized "shall be determined . . . . with reference to the amount payable on maturity or on earlier call date." Pursuant to this Section, the petitioners elected to claim on their 1953 income tax returns a deduction for bond premium amortization computed with reference to the special redemption price and to the 30-day redemption period appearing in the bond indentures. The respondent did not question the petitioners' use of the 30-day amortization period, but he disallowed the computation based upon the special redemption price and recomputed the amount of bond premium using the higher, general call price.[6] The Court of Appeals for the Second Circuit

---

premium (determined under subsection (b)) on the bond for any taxable year beginning after December 31, 1941:

"(b) AMORTIZABLE BOND PREMIUM.

"(1) AMOUNT OF BOND PREMIUM.—For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable on maturity or on earlier call date, with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

"(2) AMOUNT AMORTIZABLE.—The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

"(3) METHOD OF DETERMINATION.—The determinations required under paragraphs (1) and (2) shall be made—

"(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

"(B) in all other cases, in accordance with regulations prescribing reasonable methods of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary."

[6] At the time of the deduction in *Gourielli*, the schedule appearing in the Appalachian bond indenture provided that the bonds could

affirmed the Tax Court's orders sustaining the Commissioner's deficiency determination. 280 F. 2d 69. However, in cases presenting the identical legal issue, the Courts of Appeals for the Third (*Evans* v. *Dudley*, 205 F. 2d 713) and Sixth (*United States* v. *Parnell*, 272 F. 2d 943, affirming 187 F. Supp. 576) Circuits allowed amortization taken with reference to the special redemption prices.[1] To resolve this conflict, we granted certiorari. 363 U. S. 812.

---

be redeemed at a general call price of 105⅝ or a special call price of 103⅝. The petitioners' basis was $117.50 (see *supra*, note 2) and therefore amortization of premium with reference to the two prices would result in a deduction of $64,831.07 or $83,056.07, respectively. The difference in these amounts, $18,225.00, was the amount disallowed by the respondent. By a similar recomputation with reference to the schedule of redemption prices appearing in the Arkansas bond indenture (105.36 as compared to 101.36), the respondent reduced the deduction in *Goldfarb* by $27,175.00. The actual tax deficiency in each case was considerably less ($14,200.92 and $14,708.16, respectively), of course, because disallowance of the larger premium resulted in a corresponding increase in the petitioners' basis which had been adjusted pursuant to Section 113 (b)(1)(H) of the Code when the premium was amortized. This increase in basis resulted in a smaller short-term capital gain (the petitioners held the bonds less than six months) than had been reported by petitioners in their 1953 returns. The decrease in tax due on the capital gain was offset against the amount of amortization disallowed to arrive at the petitioners' actual tax deficiencies in issue here.

[1] In addition to the Third and Sixth Circuits' cases, the First and Seventh Circuits have also allowed deductions of bond premium amortization taken with reference to special redemption prices. In the First Circuit: *Fabrecka Products Co.* v. *Commissioner*, 294 F. 2d 876, reversing *Fabrecka Products Co.* v. *Commissioner*, 34 T. C. 290; *Sherman* v. *Commissioner*, 34 T. C. 303; and *Friedman* v. *Commissioner*, 34 T. C. 456. In the Seventh Circuit: *Gallun* v. *Commissioner*, 297 F. 2d 455, reversing 1960–104 T. C. Memo; and *Mayteel Products, Inc.*, v. *Commissioner*, 287 F. 2d 429, reversing 33 T. C. 1021. In each of these cases the taxpayer had purchased bonds at a premium, amortised that premium to the special call price, and thereafter made a distribution of the bonds which entailed a double

Bond premium is the amount a purchaser pays in buying a bond that exceeds the face or call value of the bond.[4] When a bond sells at a premium, it is generally because the interest it bears exceeds the rate of return on similar securities in the current market. For the right to receive this higher interest rate the purchaser of a bond pays a premium price when making the investment. However, interest is taxable to the recipient, and when a premium has been paid the actual interest received is not a true reflection of the bond's yield, but represents in part a return of the premium paid. It was to give effect to this principle that Congress in 1942 enacted Section 125 of the 1939 Code,[5] which for the first time provided for amortization of bond premium for tax purposes.

---

tax deduction (*e. g.*, a gift to charity). In each case the Court of Appeals allowed the double deduction. Although the precise issue presented in the instant case was not expressly decided in these latter cases, due to the fact that the Commissioner did not choose to challenge the use of the special call price as against the general call price for determining the amount of the premium, the allowance of the amortization to the special redemption price impliedly places the First and Seventh Circuits in accord with the Third and Sixth Circuits.

[4] See the authorities collected in *Commissioner* v. *Korell*, 339 U. S. 619, 627, n. 10. The Court in *Korell*, a case also involving an interpretation of Section 125 (see discussion, p. 11, *infra*), concluded (339 U. S., at 627): "We adopt the view that 'bond premium' in § 125 means any extra payment, regardless of the reason therefor . . . ."

[5] *Commissioner* v. *Korell*, 339 U. S. 619, 621. See 1 Hearings before House Committee on Ways and Means on Revenue Revisions of 1942, 77th Cong., 2d Sess. 90 (1942). The House Committee noted the recommendation made in the hearings that the difference between yield and the actual interest rate be treated as a return of capital and not as a capital loss (H. R. Rep. No. 2333, 77th Cong., 2d Sess. 47):

"Under existing law, bond premium is treated as a capital loss sustained by the owner of the bond at the time of disposition or maturity and periodical payments on the bond at the nominal

By providing that amortization could be taken with reference to the "amount payable on maturity or on *earlier call date*" (emphasis added), Congress recognized that bonds are generally subject to redemption by the issuer prior to their maturity. In electing to allow amortization with reference to the period the bonds might actually be outstanding, Congress, through the words to which we have lent emphasis, provided that a bondholder could amortize bond premium with reference to any date named in the indenture at which the bond might be called."

A bond indenture might contain any number of possible call dates, but we need only to be concerned in this

---

or coupon rate are treated in full as interest. The want of statutory recognition of the sound accounting practice of amortizing premium leads to incorrect tax results which in many instances are so serious that provision should be made for their avoidance."

However, in rejecting the Government's argument in *Kovell*, *supra*, that Congress intended to confine the deduction only to premium paid for a higher-than-market interest rate, the Court stated (339 U. S., at 626-627):

"At most, [the Commissioner's] presentation of the legislative materials suggests that Congress may have had the bondholder who was making a higher interest rate primarily in mind; but it does not establish that Congress in fact legislated with reference to him exclusively. [Citation omitted.] Congress, and the Treasury in advising Congress, may well have concluded that the best manner of affording him relief and correcting the inequitable treatment of bondholders whose interest receipts were taxable, was to define the scope of the amendment by reference to types of bonds rather than causes of premium payment."

[10] Congress' intent in this regard was expressly noted by the respondent in enacting Treas. Reg. 118, § 39.125 (b)–2:

"*Callable and Convertible Bonds.* (a) The fact that a bond is callable . . . does not, in itself, prevent the application of section 125. . . . The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer. . . ."

case with the issuer's right to call the bonds on 30 days' notice at either a general or special call price. Unquestionably, both general and special redemption provisions have a legitimate, though distinct, business purpose, and both were in widespread use well before the enactment of Section 125. The general call price is employed when the issuer finds that the current rate of interest on marketable securities is substantially lower than what it is paying on an outstanding issue. The issuer may then call the bonds at the general price and, following redemption, may refinance the obligation at the lower, prevailing rate of interest. In contrast, the provision for special funds from which bonds may be redeemed at the special call price, serves an entirely different purpose. Bond indentures normally require the issuer to protect the underlying security of the bonds by maintaining the mortgaged property and by insuring that its value is not impaired. This is done, first, through the maintenance of a special sinking fund, to which the issuer is obligated to make periodic payments, and, secondly, through the maintenance of other special funds, to which are added the proceeds from a sale or destruction of mortgaged property, or from its loss through a taking by eminent domain.[11] Although the issuer normally reserves an alternative to maintaining these special funds with cash, circumstances may dictate that the only attractive option from a business standpoint is the payment of cash and, to prevent the accumulation of this idle money, the indenture provides that the issuer may use it to redeem outstanding bonds at a special call price. It is evident that just as prevailing market condi-

[11] See generally *Evans* v. *Dudley*, 295 F. 2d 713, 715; *Estate of Gourialli* v. *Commissioner*, 289 F. 2d 69, 73; *Parnell* v. *United States*, 187 F. Supp. 576, 577, aff'd, 272 F. 2d 943. See also Badger, Investment Principles and Practices (5th ed. 1961), 46–47, 114–115, 129; I Dewing, Financial Policy of Corporations (5th ed. 1953), 186–188, 247–249.

tions may render redemption at the special call price unlikely at a given time, the same or different market conditions may also cause redemption at the general call price equally unlikely,[12] particularly in an expanding industry such as utilities. During the period the petitioners held their bonds, none were called at either price, but the risk incurred that they would be called was present with equal force as to both the general and special call provisions. The market for bonds reflects that risk, and the Section of the Code we are asked to interpret takes cognizance of that market reality.

Turning to the specific problem in the instant case, we are asked to determine whether the special price at which the bonds may be redeemed by the issuer from the limited sinking fund account and from the other special funds made available upon the occurrence of certain contingent events (see note 3, *supra*) is an "amount payable . . . on earlier call date" within the meaning of Section 125. For the reasons stated below, we answer this question affirmatively and hold that there is no basis either in the statute, in the legislative history, or in the respondent's own prior interpretations of the statute, for a distinction between reference to a general or special call price in computing amortizable bond premiums under the 1939 Code.

First, we note that the Government has made certain important concessions which lighten considerably the task before us. It does not question the right of the peti-

[12] Hence, the occurrence of a redemption at the general call price is dependent upon one set of events—the fluctuation in the interest market; the occurrence of a redemption at the special call price is dependent upon another set of events—deposits in the sinking fund by the issuer over one or more years, takings by governmental agencies through eminent domain, destruction of the property securing the bonds, etc. In either case, the events could happen. In fact, the petitioners point out in their brief here that in recent years more bonds have been called at the special redemption price than at the general price. See also *Evans* v. *Dudley*, 295 F. 2d 713, 716.

tioners to amortize bond premium with reference to the 30-day call period, nor does it question amortization to the general call price.[13] In addition, in requesting a rule which will apply to the "generality of cases,"[14] it professes to have abandoned its argument below which became the rationale of the Second Circuit in holding against the taxpayers, that the statute calls for an analysis into the "likelihood of redemption" before amortization at a special call price will be permitted.[15] Moreover, the

---

[13] Allowing a 30-day amortization period is in accord with the decision of the Court in *Korell* where, although the point was not argued by the Government, the taxpayer had amortized the premium with reference to the 30-day period provided in the indenture. In its brief in the instant case the Government states:

". . . [W]e concede that it is now too late to challenge the amortization of the premium on bonds subject to an unlimited right of redemption on 30 days' notice. Not only has the consistent administrative practice, culminating in a published ruling, been to allow such amortization, but Congress, in narrowing such deductions in the 1954 Code and prohibiting them entirely after 1957, expressly acknowledged that the prior law permitted that treatment. . . . Accordingly, we did not challenge in the lower courts and do not challenge here petitioners' right to amortization of the premium on the basis of the general right of the issuer to redeem the bonds at any time upon 30 days' notice."

See also Int. Rev. Rul. 56-398, 1956-2 Cum. Bull. 984, where the respondent, in a published ruling, acquiesced in a 30-day amortization period under the 1939 Code.

[14] This concession also conforms to the pronouncement in *Korell* (339 U. S., at 625): "Congress was legislating for the generality of cases." See also *Evans* v. *Dudley*, 295 F. 2d 713, 716; *Parnell* v. *United States*, 187 F. Supp. 576, 579, aff'd, 272 F. 2d 943.

[15] The Court of Appeals for the Second Circuit stated (289 F. 2d 69, 74): "We do not think that . . . in § 125 of the Code . . . [Congress] meant to include an amount payable on a call at a 'special' price of which there was no real possibility during the period for which the amortization is being taken and the deduction claimed." And (289 F. 2d, at 72): ". . . [T]he hazard that any significant number of petitioners' bonds would be called during [the] period was infinitesimal." In so holding, the Court accepted the Government's

Government does not contend that the transactions entered into by the petitioners were a sham without any business purpose except to gain a tax advantage.[14] Rather, the Government's position in this Court is that before an "earlier call date" is established with reference to the special call price, the taxpayer must show that "there is an ascertainable date on which the issuer will become entitled to redeem [a particular] bond at its option." The Government asserts that it is not enough that the issuer has the right to call some bonds at the special redemption price. Rather, "[i]t must have the right to call the particular bond for which amortization is claimed, for otherwise *that* bond has no 'earlier call date.'" The Government's primary reason for urging this interpretation of Section 125 is that the statute has created a tax loophole of major dimension that should be closed short of allowing the deduction sought in this case. While this assertion might have been persuasive in securing enactment of the amendments to the statute made subsequent to the time the transactions involved here took place (see discussion, *infra*), it may not, of course, have any impact upon our interpretation of the statute under review. We are bound by the meaning of the words

---

argument below that "[t]he taxpayer is not entitled to compute his amortizable bond premium deduction . . . with reference to the 'special' call price . . . because . . . such a call was so contingent and unlikely that there was no realistic call date at the 'special' call price . . . ."

In contrast, the Government states in its brief here: ". . . [O]ur position is not dependent upon the particular market conditions or the actual probabilities that a right of redemption will be exercised . . . . [W]e agree with petitioners that the question should . . . not be dependent upon a finding in each case of the actual 'likelihood' that any particular redemption right will be exercised." As to the futility in attempting to apply a "likelihood of redemption" standard, see note 12, *supra*.

[14] Cf. *Knetsch* v. *Commissioner*, 364 U. S. 361; *Gregory* v. *Helvering*, 293 U. S. 465.

used by Congress, taken in light of the pertinent legislative history. In neither do we find support for the Government's interpretation.

This Court was first called upon to construe Section 125 in 1950 in *Commissioner* v. *Korell*, 339 U. S. 619. The taxpayer there had purchased bonds at a premium which reflected in large part not a higher yield of interest, but, rather, the attractiveness of the convertible feature of the bonds. The bonds were callable on 30 days' notice and the taxpayer amortized the premium accordingly. In contesting the deduction thus taken the Commissioner contended that Section 125, in establishing a deduction for "amortizable bond premium," did not include premium paid for the conversion privilege. In rejecting this contention, the Court made it clear that Section 125 was not enacted solely to enable a bondholder to amortize "true premium," but that by "the clear and precise avenue of expression actually adopted by the Congress" (339 U. S., at 625), the legislation was adopted with "no distinctions based upon the inducements for paying the premium." (*Id.*, at 628.)

The decision in *Korell* led to congressional re-examination of Section 125, and the enactment of Section 217 (a) of the Revenue Act of 1950 (64 Stat. 906), which eliminated amortization of bond premiums attributable to a conversion feature. However, response to the *Korell* decision was specifically limited to the convertible bond situation; no further change was made in the statute which would reflect on its interpretation in the case before us.[17]

---

[17] The legislation simply provided:

"In no case shall the amount of bond premium of a convertible bond include any amount attributable to the conversion features of the bond."

Where, as in the case before us, a question of interpretation of Section 125 is presented lying outside the scope of the 1950 Amendment,

In 1954, in enacting the successor to Section 125, Section 171 of the Internal Revenue Code of 1954 (26 U. S. C. 1954 ed.), Congress again took cognizance of the tax benefit in question, and determined to eliminate the abuses inherent in permitting amortization with reference to 30-day call periods. Thus Congress further narrowed the loophole by providing that the premium on callable bonds could be amortized to the nearest call date only if such date was more than three years from the date of the original issue of the securities. With particular relevance to the Government's argument in the instant case, it is worthy of note that Congress understood the operation of the statute to the taxpayer's advantage, but limited correction of the abuses inherent in it to elimination of the quick write-off. The House Report accompanying H. R. 8300, which was to become the Internal Revenue Code of 1954, stated (H. R. Rep. No. 1337, 83d Cong., 2d Sess. 26):

> "Under existing law, a bond premium may be amortized with reference to the amount payable on maturity or on earlier call date, at the election of the taxpayer. In the case of bonds with a very short call feature, such as those providing for call at any time on 30-day notice, the entire premium may be deducted in the year of purchase.

Korell retains its full vitality. Thus, it is worth noting that the Government's "right to call" approach advocated in the case at bar would result in a *sub silentio* overruling of *Korell* to the extent that in the latter case the right of the bondholder to exercise his conversion option at any time through the expiration of the notice period of a call defeated completely the issuer's "right" to call and redeem even a single bond. In the instant case, however, neither party disputes the fact that at least some of the bonds could have been called at the special price and that if the issuer exercised his right so to call them the bondholder would have had no choice but to turn over the bonds and forfeit the premium paid for them.

"This provision has given rise to the tax-avoidance opportunities. Substantial bond issues have been made subject to a 30-day call, permitting the purchaser to take an immediate deduction for the entire premium against ordinary income. *When the call feature is nominal or inoperative,* this permits a deduction for an unreal loss, since the market value of the bonds ordinarily remains fairly stable over considerable periods. The bonds may then be resold after 6 months subject to long-term capital gain treatment. The write off of premium thus affords a gratuitous tax saving, equivalent to the conversion of a corresponding amount of ordinary income into capital gain. This process may be repeated indefinitely.

"To curb this type of abuse, your Committee's bill provides that the premium on callable bonds may be amortized to the nearest call date only if such date is more than 3 years from the date of original issue of the securities. *This provision will apply only to bonds issued after January 22, 1951, and acquired after January 22, 1954.*" (Emphasis added.)

Not only did Congress fail to make the distinction between general and special call provisions urged by the respondent, but it expressly recognized that deductions could be taken under Section 125 with reference to a call date that was "nominal or inoperative." It did not remotely imply that a showing of a right to call all or any part of the outstanding bonds was necessary for operation of the statute. Furthermore, the change that it did adopt was to operate prospectively only.

Finally, in 1958, by adoption of Section 13 of the Technical Amendments Act of 1958, 72 Stat. 1610, Congress eliminated entirely the right to amortize to call date, permitting amortization to be taken only over the period to

maturity.[18] Again, the legislative change was prospective only and again no distinction was made with respect to general and special call dates or with respect to a right to call all or a part of the outstanding bonds.

Persuasive evidence that we are correct in our interpretation of Section 125, as bolstered by its legislative history and subsequent amendments, may be found in the respondent's own prior construction of the statute. As is true with the language of the statute itself, the respondent's regulations contained not the slightest hint of the distinction urged upon us here. The Commissioner defined "earlier call date" in Treas. Reg. 118, § 39.125 (b)–2 (see note 10, *supra*) as any call date, prior to maturity, specified in the bond. The regulations in effect in 1953 give no support to the Government's present contention that the taxpayer must show an unconditional right in the issuer to call the outstanding bonds at a particular redemption price before amortisation with reference to that price would be permitted. Furthermore, although the petitioners are not entitled to rely upon unpublished private rulings which were not issued specifically to them,[19] such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws. And, because the Commissioner ruled, in letters addressed to taxpayers requesting them, that amortisation with reference to a

---

[18] The 1958 Amendment literally permits amortisation to an earlier call date but only if it results in a *smaller* amortisation deduction than would amortisation to maturity, which, for all practical purposes, effectively eliminates the privilege of calling to an earlier call date.

[19] See, *e. g.*, *Commissioner* v. *P. G. Lake, Inc.*, 356 U. S. 260, 265–266, n. 5; *Automobile Club* v. *Commissioner*, 353 U. S. 180; *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 467–468.

special call price was proper under the statute,[20] we have further evidence that our construction of allowable bond premium amortization is compelled by the language of the statute.[21]

A firmly established principle of statutory interpretation is that "the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses." *Crane* v. *Commissioner*, 331 U. S. 1, 6.[22] The statute in issue here, in plain and ordi-

---

[20] For example, the record in the instant case contains a copy of the following letter to a taxpayer from the respondent's office (we quote the relevant portion):

"Gentlemen:

. . .

"The Appalachian Electric Power Company 3¼% bonds, 1981 Series, are callable in whole or in part through May of 1953 at 105⅝. They are also callable for sinking fund through funds derived from maintenance or sale of property at any time upon thirty days notice through May 31, 1954, at 102⅜. You request to be advised whether the above-mentioned ruling of July 30, 1952, means that such bonds may be amortized down to 102⅜ or whether it means that they can only be amortized down to 105⅝ through May of 1953.

"Upon the basis of the information on file in this office, it is the opinion of this office that a taxpayer electing to amortize the premium on Appalachian Electric Power Company bonds in accordance with section 125 of the Code may use the regular redemption price of 105⅝ or the special redemption price of 102⅜.

"Very truly yours, [etc.] . . ."

[21] In 1956, three years after the deductions in the present case were taken, the Commissioner—reversing the position he had previously and uniformly adhered to in a series of private rulings—for the first time announced that amortization of bond premium under Section 125 of the 1939 Code was to be limited to premium in excess of a general call price and could not include premium in excess of a lower special call price, except where an actual call was made at the latter price. Int. Rev. Rul. 56-396, 1956-2 Cum. Bull. 984.

[22] See also *Korell* v. *Commissioner*, 339 U. S. 619, 627–628; *Lang* v. *Commissioner*, 289 U. S. 109, 111; *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 560.

nary language, evidences a clear congressional intent to allow amortization with reference to any call date named in the indenture. Under such circumstances we are not at liberty, notwithstanding the apparent tax-saving windfall bestowed upon taxpayers, to add to or alter the words employed to effect a purpose which does not appear on the face of the statute. Moreover, the legislative history, too, is persuasive evidence that the statute, as it appeared in 1953 when these deductions were taken, allowed the deduction refused these taxpayers. Simply stated, an informed Congress enacted Section 125 with full realization of the existence and operation of special call provisions, but chose not to make any distinction between them and general redemption rights. Neither did the Commissioner. Nevertheless, the Government now urges this Court to do what the legislative branch of the Government failed or elected not to do. This, of course, is not within our province."[22]

The judgments are reversed.

MR. JUSTICE FRANKFURTER took no part in the decision of this case.

MR. JUSTICE WHITE took no part in the consideration or decision of this case.

---

[22] We believe the Court of Appeals for the First Circuit was correct when it said in *Fabreeka Products Co.* v. *Commissioner*, 294 F. 2d 876, 879: "Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's." See also *Evans* v. *Dudley*, 295 F. 2d 713, 715, where the Third Circuit quotes this language from Judge Aldrich's opinion in *Fabreeka Products*.